



STATE BOARD OF EQUALIZATION

120 N STREET, SACRAMENTO, CALIFORNIA

P.O. BOX 1799, SACRAMENTO, CALIFORNIA 95808

(916) 445-4982

GEORGE P. REILLY
First District, San FranciscoIRIS SAN
Second District, San DiegoWILLIAM M. BENNETT
Third District, San RafaelRICHARD NEVINS
Fourth District, PasadenaKENNETH CORY
Controller, SacramentoDOUGLAS D. BELL
Executive Secretary

February 9, 1979

No. 79/30

TO COUNTY ASSESSORS:

WELFARE EXEMPTION

A recent decision by the California Appellate Court causes us to change our position concerning the granting of the welfare property tax exemption to property which is owned by one welfare exempt organization but leased to another welfare exempt organization. (See Christ the Good Shepherd Lutheran Church v. Mathiesen, (1978) 18 Cal. App. 3d 355.)

81

Prior to this court decision, we advised county assessors that a property owned by one exempt organization and leased to another exempt organization would be granted a welfare exemption provided:

"...the rent received by the lessor should not exceed the cost of making the property available, that is, utility, maintenance, and/or repair costs incurred because of the use of the property by the lessee. Otherwise the property would be considered used for profit-generating purposes in the hands of the lessor and, therefore, ineligible for exemption." (See p. 26 of Assessors Handbook 267, Welfare Exemption, revised December 1977.)

We advised that leases that included these operating costs plus depreciation based upon replacement, and principal and interest payments on the property exceeded the bounds of a qualified lease because it was profit generating. However, the court examined this administrative policy in the situation where one religious organization leased to another religious organization for a rental amount equal to or less than market rent. The court found:

"It was never the intent of the statute or the constitutional provision to prohibit an exempt organization from conducting activities which produce an income over and above operating expenses...." (Christ the Good Shepherd, supra, p. 363.)

and the court concluded:

"...the fact that rental income may exceed operating expenses in a given year will not disqualify a tax-exempt lessor from receiving the welfare exemption on real property leased to another exempt organization where the property is exclusively used for exempt purposes and such leasing arrangement is not intentionally profit-making or commercial in nature." (Christ the Good Shepherd, supra, p. 366.)

Therefore, whether such a lease agreement falls within qualifying bounds turns upon whether it is found "not intentionally profit-making or commercial in nature." The court did not provide any clear or precise test for use in making such determination, however. Thus, we suggest the following guides indicate a non-qualifying lease:

1. The property was acquired by the welfare exempt owner specifically for leasing to other welfare exempt organizations, rather than for its own use.
2. The rent charged is greater than 10 percent over and above all operating costs. Operating costs include the cost needed to make the property available, that is, utility, maintenance, and/or repair costs incurred because of the use of the property by the lessee, and an amount necessary to cover the expense of depreciation based on cost of replacement and amortization of, and interest on, indebtedness.

When presented with a lease situation then, we suggest you examine the lease, consider the above guides and others as appropriate, and reach a conclusion, as would a reasonable person, as to whether the lease would be nonqualifying by reason that it is "intentionally profit-making or commercial in nature." If you conclude that a lease is nonqualifying, please so indicate in B 1 f (fund-raising) on the Field Inspection Report and

February 9, 1979

provide your calculation of the 10 percent income over expenses in F (Recommendation) on the report or on the reverse side of the report. Keep in mind that depreciation must be based on cost of replacement, not on book cost. Please also indicate in F (Recommendation) on the report any instance in which rent charged is \$1,000 or more per month.

Additionally, as a result of the court's decision, any property denied the welfare exemption in past years solely because it had been leased to another welfare exempt organization for an amount greater than the cost of making the property available may be granted exemption for those years provided:

1. A timely claim or claims for refund are filed.
2. Amended findings are requested.
3. The lease agreement is "not intentionally profit-making or commercial in nature", as discussed above.

In order for us to be able to issue amended findings (Been Met), you must provide us with amended field inspection reports, one for each year involved and each containing the lease terms pertaining to the premises and to the rental paid for the lease period, for example:

1. \$3,600 per year for week-day use of Church Sunday School Building; or
2. \$300 per month for exclusive use of second floor of Boys Club building.

Subsequent to our review, we will forward amended findings or otherwise communicate with you.

Please refer any inquiries or additional questions to Mr. William Grommet of our Assessment Standards Division, (916) 445-4982.

Sincerely,



Verne Walton, Chief
Assessment Standards Division

VW:fr

February 22, 1979

Dear _____:

This is in response to your November 30, 1978, letter wherein you requested that we reconsider our October 13, 1976, opinion, that property leased by the American Baptist Seminary of the West to the University of California was not eligible for the college exemption for the 1974-75 fiscal year, in light of the recent decision of the West to the University of California was not eligible of the recent decision of Christ the Good Shepherd Lutheran Church of San Jose v. Mathiegen, 81 Cal. App. 3d 355.

At issue in your situation, as in Christ the Good Shepherd, was the amount of the rents received for the property. For your stipulation, the rent was less than commercial rent in the area but was sufficient to reimburse the seminary for the expenses of leasing the property, including items such as utilities, maintenance and repairs, and to cover a portion of the reasonable depreciation of the portions of the buildings leased, or, alternatively, to pay a portion of the principal and interest on the loans to the Seminary which were secured by the portions of the property leased.

Enclosed is a copy of our February 9, 1979, Letter to Assessors No. 79/30 advising as to how Christ the Good Shepherd should be interpreted for welfare exemption purposes. In sum, while each lease situation will be reviewed independently, we are of the opinion that a lease agreement is not intentionally profit-making or commercial in nature where the rent charged is less than 10 percent over and above all operating costs, which include the cost of making the property available and an amount for depreciation based on cost of replacement and amortization of, and interest on, indebtedness.

We would advocate use of the Letter to Assessors' rationale in the administration of other exemptions also, including the college exemption. If then, as appears to have been the case, the rent charged by the Seminary did not exceed operating costs, the basis for our October 13, 1976, opinion will have been eliminated, and rent charged will no longer prevent the Seminar from being eligible for the exemption. As evidenced in our Letter to Assessors, we believe that any property denied exemption in past years solely because of rent charged may be granted exemption for those years provided timely claims for refund have been filed.

Very truly yours,

James K. McManigal, Jr.
Tax Counsel

JKM:fr
Enclosure

cc:

bcc: